

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-52007; File No. SR-NSX-2005-02)**

**July 11, 2005**

**Self-Regulatory Organizations; National Stock Exchange; Order Granting Approval to Proposed Rule Change, and Amendments No. 1 and 2 Thereto, Relating to the Composition of NSX's Board of Directors and Committees**

On March 31, 2005, the National Stock Exchange (the "Exchange" or "NSX") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its By-Laws to make modifications to the composition of its Board of Directors ("Board") and committees. On March 31, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On May 19, 2005, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>4</sup> The proposed rule change, as amended, was published for comment in the Federal Register on June 7, 2005.<sup>5</sup> The Commission received no comments on the proposal.

In connection with a termination of rights agreement ("Termination Agreement") entered into between NSX and the Chicago Board Options Exchange, Incorporated ("CBOE") on September 27, 2004, and in order to conform to recent industry trends and comply with regulatory requirements that the Commission may impose upon self-regulatory organizations, the

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 replaced the original filing in its entirety.

<sup>4</sup> In Amendment No. 2, the Exchange revised the proposed definition of "Independent Director."

<sup>5</sup> See Securities Exchange Act Release No. 51765 (May 31, 2005), 70 FR 33238.

Exchange proposed various changes to its By-Laws. The Exchange proposed the following changes relating to Board composition, terms of office and candidate selection: (A) change the position on the Board reserved for the President of the Exchange in favor of the NSX's Chief Executive Officer;<sup>6</sup> (B) combine the two Designated Dealer and one At-Large Member positions on the Board into a single "Member Director" category, which would be defined in proposed Article V, Section 1(a)(ii) of the NSX By-Laws as "Proprietary Members or executive officers of Proprietary Member organizations," and which would continue to consist of three positions; (C) modify the Member Director candidate selection process described in Article V, Section 2.2 of the NSX By-Laws to clarify that the annual election, at which Proprietary Members vote for the candidate(s), occurs during the annual meeting of the membership, which is in January; (D) eliminate the existing Public Director<sup>7</sup> category in favor of an "Independent Director" category, which would be defined in proposed Article I, Section 1(k) of the NSX By-Laws as "a member of the Board that the Board has determined to have no material relationship with the Exchange or any affiliate of the Exchange, any member of the Exchange or any affiliate of any such member, other than as a member of the Board" and increase the number of such directors from three to six positions; (E) delete provisions relating to the procedure for selecting Public Directors and replace such provisions with the procedure for selecting Independent Directors; (F) combine the CBOE Chairman, CBOE President and CBOE Member Director positions on the Board into a

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<sup>6</sup> The President and Chief Executive Officer are currently the same person.

<sup>7</sup> "Public Directors" are defined as "representatives of issuers and investors who shall not be associated with any member of the Exchange or with any registered broker or dealer or with another self-regulatory organization, other than as a public trustee or director[.]" Article V, Section 1.1(g) of the NSX By-Laws.

single “CBOE Director” category, which would be defined in proposed Article V, Section 1(a)(iv) of the NSX By-Laws as “executive officers of CBOE, CBOE members or executive officers of CBOE member organizations” and decrease the number of such directors from six to three positions; (G) modify the definition of “CBOE member(s)” to delete the requirement, in the case of a transferable regular CBOE membership that is subject to a lease agreement, that the lessee and not the lessor be deemed to be the CBOE member and reorganize the list of definitions in alphabetical order and renumber the provisions accordingly; and (H) modify the provisions relating to Directors’ terms of office to, among other things, add procedures to account for when new Member Directors’ and new Independent Directors’ initial terms would begin.

Further, the Exchange proposed to adopt provisions to accommodate future Board composition changes, which would achieve a Board comprised of a majority of Independent Directors, resulting from subsequent closings under the Termination Agreement.

Finally, the Exchange proposed to revise the general composition requirements for committees contained in Article VI, Section 1.4 of the NSX By-Laws to provide that the membership of such committees would be chosen in such a way as to assure the fair representation of the public and, as appropriate, all classes of members, and to delete references in: (a) Article VI, Section 1.4 of the NSX By-Laws to the requirements that at least one member of each committee be a member of the Board and that all members of the Executive Committee be members of the Board, and (b) Article VI, Section 3.1 of the NSX By-Laws to the requirements that the Securities Committee have at least one Proprietary Member and at least one representative of issuers and investors who is not associated with a member or a broker or

dealer, and certain other composition requirements that are no longer applicable.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>8</sup> and, in particular, the requirements of Section 6(b) of the Act<sup>9</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with Section 6(b)(5) of the Act<sup>10</sup> in particular, which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest and Section 6(b)(1) of the Act,<sup>11</sup> which requires that an Exchange be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members, with the Act.

The Commission notes that the proposal is designed to implement changes made necessary by the terms of the Termination Agreement. These changes, in part, result from the relinquishment by CBOE of its three NSX Board positions, as well as, CBOE's anticipated relinquishment of additional NSX Board positions. The Commission further notes that the revisions relating to Exchange governance, such as the creation of a new category of directors known as "Independent Directors," the implementation of a transition schedule for having a

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<sup>8</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 15 U.S.C. 78f(b)(1).

majority of NSX's thirteen member Board consist of Independent Directors, and the various changes to the composition of NSX's committees, are being made in anticipation of certain governance requirements that the Commission may impose upon self-regulatory organizations. The Commission believes that a Board consisting of a majority of independent directors should help address the conflicts of interest that otherwise may arise when persons with a relationship to the Exchange are involved in key decisions, and should increase the likelihood that the Board will act in accordance with the mandates of the Act and in the best interests not only of the Exchange but also investors.

Therefore, in the Commission's view, the proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Sections 6(b)(1)<sup>12</sup> and 6(b)(5)<sup>13</sup> of the Act.

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<sup>12</sup> 15 U.S.C. 78f(b)(1).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-NSX-2005-02) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).